Banking and Its Relationship to Domestic Business and Export Trade

An Address by

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The letter of your president inviting me to address you today was in the nature of an indictment of banks and bankers. He said it has been shown that the banks cooperate readily with business in times of prosperity, but that when hard times come they withdraw assistance. He asked me for an explanation. I am glad he put his invitation on these terms because it promptly convinced me that it was my duty to take the time and thought to answer the accusation.

Yet I do not feel that I am here to plead a cause or argue a defense. I have come here, rather, to discuss frankly with you the relationship between business and banking under conditions which obviously have given rise to a misunderstanding that I believe can be cleared away.

If any responsible business man sincerely feels that banks as a class do less than their duty toward business, he has a right to

a fair answer. It is not sufficient to say that a bank should think first of itself and is entitled to do as it sees fit with the resources which it controls. That is not a fair answer because a bank's resources are not its own private means. The banking credit of the country as a whole is, in effect, a public utility, a great national resource, constituting the country's chief instrument of business. In handling its portion of these resources, therefore, a bank becomes a semi-public institution with heavy responsibilities, not only to its own stockholders, but to its depositors, and also to general business welfare.

These responsibilities impose the obligation upon the banks to exercise sound judgment in credit policy, and to determine whether general conditions as well as specific expediency require liberality or conservatism in making loans. For, just as a wall is built up brick by brick, so the country's credit structure is built up loan by loan, and each individual loan adds strength to the business fabric if it is properly made and properly placed, but weakness if it is not.

It is the high duty of the banks to exercise their best judgment to see that each unit in the financial structure is properly made and properly placed, and I can say to you that the credit structure was never better built than it is today, because our bankers have clearly seen and loyally fulfilled their duty in spite of a more or less popular demand for an expansion of credit that would have been disastrous.

I came to discuss these matters with you frankly. It would be less than frank not to admit at the outset that there is historical basis for the accusation that in the past the banks cooperated freely with business when times were bright and profits were sure, but withdrew support from business when trouble loomed ahead. There were conditions which made such action inevitable. Before the establishment of the Federal reserve system there was no great organized unit in the nation's banking structure. It was merely a great collection of banks, impelled by about the same motives, but not coordinated in action. The structure was so fundamentally weak in this respect that the banks were not able to maintain a broad-minded attitude toward business in the interest of the public welfare when the expansion of prosperity had brought a crisis, or possibly a panic. A function of the

banks is to make profits, and in times of prosperity it was but natural that they should compete for all the business they could get and that many of them in the heat of this competition should become individually extended. As this tendency progressed there would come the realization that banking and business conditions in the country were reaching a state of expansion that demanded readjustment. Unorganized as they were, the banks had to act as independent units. They had only two ways to fortify their own position,—that is, by individually conserving their gold reserves and by contracting their loans. Curtailment of accommodation to business was imperative. If conditions were progressing rapidly toward a serious state, abrupt curtailment was necessary. You must remember that, before the organization of the Federal reserve system, each bank carried its own gold reserve and had no sure means of shifting the burden of its loans when they became too heavy for it to carry alone. Its only relief was in reducing them. Clearing House associations constituted loose local federations that helped in a measure in emergencies, but they did not answer fundamental needs. Under such conditions, therefore, it was often a case of self-preservation, regardless of others or of the integrity of the general business situation.

Strength of the Federal Reserve System

Under the Federal reserve system, however, this fundamental weakness in our banking structure has been corrected. The gold reserves of the country have, in effect, been pooled for the benefit of all so that the total monetary gold stock of the nation virtually underlies the total credit structure, supporting it at all points. Moreover, there are quick acting means provided for the shifting of reserves, if emergency demands it, to points where most needed.

Under former conditions some banks saw their reserve sink far below legal requirements and could not force the better supplied banks to share with them, being dependent upon voluntary friendly assistance. Such inequality was a menace to the whole business structure, leaving as it did many weak spots with no sure means provided for those needing aid to lean upon the strong.

Under present conditions, however, there is no occasion for banks to hoard gold, because their reserves are no longer held in their own vaults. They are merged in a general fund in the hands of the Federal reserve banks and have become, in effect, a great bed-rock upon which the total banking structure is firmly based. Thus is the reserve situation strengthened, and through the rediscount facilities of the Federal reserve banks prime commercial paper in the portfolios of member banks is made available for the further relief of business.

Additional strength is given to the business structure by the elasticity imparted to our currency through the issue of Federal reserve notes based on rediscounted commercial paper. This keeps the currency truly responsive to economic needs, increasing in volume as business activity and commercial loans expand, and shrinking as the volume of credit is liquidated. In active times ample currency for business needs is provided, and in slackened times it is not in oversupply.

Rediscounting operations among the twelve Federal reserve banks, serve to equalize the credit strain throughout the country, keeping the nation's credit resources fluid as a whole so that they can flow wherever needed. Through the pooling of resources the strength of all is automatically the strength of each.

The question remains, with the machinery thus provided for cooperating with business to the fullest extent, do the banks fail to cooperate when they are most needed. I believe we will understand each other more fully if we pause a moment to define just what bank cooperation with business means.

Bank cooperation with business may be classed as of two kinds; first, direct cooperation through extending credits, and secondly, indirect cooperation through maintaining the integrity of the general business situation.

In the matter of extending credits, sound banking requires an analysis and judgment of each specific credit risk, involving careful consideration of the financial set up and the ability of the management of the particular company seeking the loan. It also requires analysis and judgment as to conditions in the concern's particular field of activity for the purpose of determining whether those conditions indicate that it will be able to carry out its business projects. Only when it is satisfied on these points is a bank

called upon to give direct cooperation by granting the loan.

Indirect cooperation with business on the part of banks takes a broader view than is required in this detailed consideration of individual transactions. It is the duty of the banks, and a part of their cooperation with business, to keep themselves thoroughly informed at all times as to the general business and economic situation and as to the relationship of the general credit structure to the nation's reserves.

Also it is the duty of each bank to keep its own condition continually in mind because its own credit structure is a part of the credit structure of the nation, lending strength or weakness, as the case may be, to the total situation. It is the prime duty of a bank to remain sound and liquid so that there shall never be any hesitation in meeting its demand obligations.

A commercial bank depends for its own solvency upon the solvency of its borrowing customers and the solvency of its borrowing customers depends not only upon their financial structure and their management, but also upon general business and economic conditions. Therefore, when the banks realize that the business situation is becoming unduly expanded and that the necessity is approaching for a contraction in the business structure, it is their duty, both to themselves, to their customers and to general business welfare, not only to apply with the utmost care all of their means of analyzing and judging applications for accommodation but also to counsel conservatism in business operations.

Duty of Banks to Look Ahead

The banks owe it to business not to allow themselves to become embarrassed. Nothing is more potent in bringing on a state of depression, nothing is more destructive to public morale, than the closing of the doors of banks. Therefore, they should be quick to anticipate prospective trouble. They should exercise premature rather than tardy caution. Even under the Federal reserve system there is a point in credit expansion beyond which it is not safe to go, especially when the liquidity of credit has become impaired. A bank which over-extends itself has less real regard for the interest of business, and is really cooperating less

with business, than one which frankly counsels and practices conservatism when conditions require such action.

It is far better that many business concerns should contract their operations for a time if need be, than that a bank should become embarrassed through over-extending itself to grant them unwise accommodation. I say this not only from the viewpoint of a banker but rather from the viewpoint of any business man who has the foresight to consider his business interest in the long run and not only in its immediate aspect.

When general business conditions become critical it is not the duty of the banks to attempt to force a continuance of activity by artificial stimulation. It is not their duty to provide funds for expansion when business prudence counsels conservatism. It is rather their duty, and their best form of cooperation with business, to do their utmost under such conditions to persuade their customers to curtail borrowings in the interest of the general situation.

But I do not mean to say that the banks do their full duty by preaching conservatism and practicing curtailment. Where their own position warrants it they should lend freely to enable solvent concerns to meet their quick liabilities. It is their business and their function to assist solvent firms to mobilize slow assets, but it is not their duty to validate bad assets of insolvent firms. They may sometimes find it advisable further to assist a firm which is largely but not wholly good for its liabilities in order to prevent it from throwing its assets on a demoralized market. If a concern is temporarily embarrassed, it is the duty of the banks to grant it their assistance rather than to allow it to go to the wall.

I do not believe we can have any difference of opinion on the proposition that the banks have a civic duty to perform on both sides of the question,—that is, to counsel and exert themselves against over-expansion on the one hand, and on the other, when critical times come, to assist deserving firms in an effort to keep the total business structure from collapsing. But it is equally true that business also has a duty, and that is, not to demand too much of the banks. It is never the duty of a bank to wreck or jeopardize itself in an attempt to bolster up a business position which should not have been created and should not be maintained.

Banking and business must work together to readjust strained

conditions and to prevent a crisis from running into a panic. If they do work together this country need never see another panic. In the past virtually every crisis became a panic because of our inelastic credit and currency which made timely adjustment impossible.

The great exception to the rule was the crisis of 1914 which did not become a panic because the provision of emergency currency under the Aldrich-Vreeland Act made possible the rapid expansion of the currency to meet the unusual needs of the critical period. It was possible for the banks generally to make such new loans as were necessary for the protection of solvent business and a panic was averted. Since then the Federal reserve system has taken up the task of maintaining the elasticity of the currency and has gone further in providing ample elasticity for our credit structure.

Although a great deal of readjustment lies ahead, we should not again see such conditions in this country as developed in the panics of 1893 and 1907. The banks and business men now have in their hands adequate means for avoiding a panic. Having the means, our responsibility is just so much the greater to conduct our affairs along sound lines so that the business structure of the country shall not get into such straits as to bring on a critical condition. Whereas the great panics of the past were due to circumstances beyond our control, a panic under conditions that exist today would be chargeable to inefficiency and a dereliction of duty on the part of the banks and of business men first in not looking ahead and secondly, in not insisting that business be conducted according to the clear dictates of prudence.

How the Banks Have Cooperated

During the period through which we have recently passed, despite the unprecedented problems and conditions to be contended with, the loyal cooperation of the banks with business maintained the soundness of the business structure in a way never before witnessed in this country. If any one feels that the banks as a whole have not cooperated with business as they should, it is because he does not fully appreciate the fundamentals involved.

A consideration of the facts in the case will make this clear.

The great financial feature of the present business era was the tremendous inflow of gold into this country accompanied by a rapid expansion of our credit structure. In fact, great as was the increase in our gold base, the expansion of our credit structure far outran it, so that we witnessed a continual dwindling of the reserve ratio. This credit expansion was caused by Government war paper, by great commercial activity and by European credits. Yet, although the falling reserve ratio called for careful attention, it was not the chief cause of anxiety, for we have passed beyond the stage in our financial development where we believe that a fixed ratio is necessary.

The chief weakness in our situation was caused by the non-liquid character of a large part of the credit structure produced by the necessity of financing by long time credits war goods that were rapidly destroyed, leaving the credit structure expanded without a complete physical base to support it. Under normal conditions consumption goods are financed by short, self-liquidating credits, which are released to finance new oncoming cycles of production as the goods they are used to finance pass on into consumption. In the war period after a large volume of goods, financed by long time credits, had disappeared into consumption, the long time credit still remained a load upon our banking resources.

While our credit structure was in this highly expanded and largely non-liquid condition, abnormal shortages of goods and extravagant public buying produced higher prices, higher wages, speculation and inflation. Finally, the difficulties of the situation were augmented by the transportation breakdown which rendered our credit even less liquid by delaying the turnover of goods and the paying off of loans.

In this complex situation the volume of gold in this country began to shrink as we continued to sell to Europe on credit but paid cash to other parts of the world where the balance of trade was against us. The result of all these factors was a very heavy pressure on our credit resources making it advisable for the banks to conserve their positions with the utmost care. To do so was the best service they could render business, for business more than ever needed strong banks. Weakened banks would have meant disaster.

The peak of credit expansion must soon pass, but this does not mean that there are not ahead of us many serious and necessary adjustments. There must be established stable price levels so that business can be conducted on a basis of confident judgment rather than of guess and speculation. There must also be adequate production, primarily in the more substantial lines of goods, so that we shall not continue to live on a narrow hand-to-mouth margin, which is responsible for unstable prices. We must conserve credit so that there will be ample funds for long time investment to provide for the rehabilitation of essential permanent equipment, railroad building and repair, and necessary housing construction.

With these necessary readjustments before us, I believe the duty of the banks of the country is clear. It is their duty to interpret the needs of business in view of these foregoing considerations. Since the banks touch all phases of industry and business, they are able to obtain a broader view of the total business situation than is the individual business man, whose enthusiasm or anxiety over his own line may obscure his vision to the greater need and even to his own best interests. The condition of the country is the balance sheet of the banks, not merely their own books.

Requirements of the Situation

The banks have seen clearly the necessity of conserving our credit resources lest the financial structure of the country should become over-expanded and weakened. They have seen, too, the need of production, price stability and adequate transportation. They have realized that our business energies must not be diverted from these requirements. Seeing these things clearly it has been their responsibility to act in accordance with them.

Therefore, I believe that it is due to a misconception or to failure to give due weight to fundamental facts, if business feels that there has been any tendency on the part of the banks to fail to cooperate with it to the fullest extent in the present business era. Seen in its true light, the attitude of the banks has been the only true cooperation possible. Any other attitude on their part would have been non-cooperation, making more difficult the period of

readjustment and recovery to normal, stabilized business, which is what we all want.

I do not believe that the attitude of banks should be paternalistic toward business nor that it has been, but that they have acted in cooperation with business and in the best interests of all concerned. A bank which does otherwise than that does less than its individual and its public duty. The problems of business are the problems of the banks. The two are not in any sense on different sides of the question. They are both on the same side working together for mutual advantage. If conditions make it good for business to borrow, it is good for the banks to lend, and if conditions make it bad for the banks to lend, it is bad for business to borrow.

The problem of the American manufacturer in export trade, in which you are most particularly interested, is one of the great problems before the bankers of the country today. But it is a problem that is not to be considered as apart from our general business problem. What differences there may be between foreign and domestic trade are differences of detail and not of general principle.

The considerations that I have outlined as applying to the attitude of banking in cooperating with business apply with especial force in connection with our foreign trade. International business is in a particularly active period of transition and adjustment. During the war period the ratio of our foreign trade to our total domestic trade has undergone violent changes, foreign business occupying for a time an abnormal importance. There was also produced an abnormal balance of foreign indebtedness in our favor.

Just what ratio between our foreign trade and our domestic trade may come to be established as normal it is impossible to say at present. But it can be said that a closer approximation to equilibrium between our export and import trade must be expected, whether that be brought about through a decrease of our exports, an increase in our imports, or both.

If a marked recession in our export trade should prove to be one of the corrective factors tending to stabilize international trade, it is my belief that such a recession should be accepted as economically sound and that we should not incur the dangers of

seeking to stimulate by artificial measures the volume of our foreign trade. Where there is a real demand for our goods there will be a real market. It is the business of the banks to finance goods for real markets. It is not their business to attempt to maintain expanded foreign trade when it becomes manifest that there is not the continued economic basis for that expansion.

A comprehensive view of the foreign situation indicates that the real and basic need of Europe is for our raw products. She needs them to reestablish her own industries upon a fundamentally productive basis, increasing her export powers so as to liquidate her adverse balance of indebtedness. Her need is for raw products rather than for many classes of our manufactured products which during the war period she had to purchase from us but which, as her own industrial organization is rehabilitated, she can increasingly produce for herself without reliance upon us.

Foreign Trade Considerations

It is the duty of the bankers to advise with business as to the conditions abroad and as to the prospects of the countries with which we are doing business being able to liquidate ultimately the balances of indebtedness which they owe to the United States. The desire for immediate profits should not obscure our vision of the future.

Also in financing our foreign trade we must not lose sight of our business situation as a whole. We must not finance our foreign trade on a basis that will perpetuate over-expansion in our domestic banking credit. The great bulk of Europe's debts to us is in the form of long time credits or of commercial credits which it seems impossible to realize on at once. This is a serious element of non-liquidity in our credit structure. If it is necessary to readjust our domestic credit situation, our foreign trade also must be subject to that necessity. The liquidity of our commercial credit structure should be a chief concern. Therefore, it is one of the preeminent duties of the banks to encourage a return as fast as possible to reciprocal foreign trade in equilibrium financed by liquid credits.

The most desirable foreign trade is that with countries which give most promise of being able to reestablish their own produc-

tivity and to regain at the earliest moment the ability to liquidate their debts here with goods. It is also but the part of wisdom to favor, in our trade with those countries, such products of ours as will serve most rapidly to help them return to a condition of economic stability.

These are all practical considerations for business men as well as bankers. Banks make money by helping others make money. The way for business to make money is to make sure that the profits of today shall not be wiped out by the losses of tomorrow. The only way in which this can be assured is to see to it that the business structure which is built today is not built so weakly that it will collapse under the demands of tomorrow.

Therefore, when bankers see that business conditions have reached a stage of expansion that requires readjustment, they should fearlessly take what steps are necessary in the situation. Their action must be based on self-interest, on the demands of business and above all on the best interests of all concerned. This is my conception of true banking cooperation with business.

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